Supreme Court, U.S.
FILED
MAR 14 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1371

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK,

Petitioner,

v.

FORBES INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE NEW YORK COURT OF APPEALS

BRIEF IN OPPOSITION

ARNOLD BAUMAN
Counsel of Record

SHEARMAN & STERLING
53 Wall Street
New York, New York 10005
(212) 837-6860

Of Counsel:
CLARENCE W. OLMSTEAD, JR.
WILLIAM E. FLOWERS
KENNETH A. CARUSO
DANIEL LAVIN

Attorneys for Respondent

March 14, 1986

QUESTION PRESENTED

Does New York City's General Corporation Tax discriminate against federal obligations, in violation of 31 U.S.C. § 742 (and hence, in violation of the Supremacy Clause), because, in the calculation of taxes due, the City tax law renders investments in federal obligations less attractive than investments in corporate obligations and obligations of the 49 states other than New York?

TABLE OF CONTENTS

	PAGE
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iii
STATEMENT OF THE CASE	1
A. *The New York City General Corporation Tax*	2
1. The Income Allocation Rules—Calculation of The Investment Allocation Percentage	2
2. The 18 Percent Rule	3
B. *The Decision Below*	4
SUMMARY OF ARGUMENT	6
ARGUMENT	
THERE ARE NO SPECIAL AND IMPORTANT REASONS FOR REVIEW	6
A. *This Case Presents No Unsettled Question*	6
B. *This Case Presents No Decisional Conflict*	7
C. *The Decision Below is Correct*	8
D. *This Case Presents an Issue of Limited Significance and Impact*	9
CONCLUSION	10
LIST OF SUBSIDIARY CORPORATIONS	

TABLE OF AUTHORITIES

Cases	PAGE
American Bank & Trust Co. v. Dallas County, 463 U.S. 855 (1983)	6
Commonwealth v. Curtis Publishing Co., 363 Pa. 299, 69 A.2d 410 (1949), *cert. denied*, 339 U.S. 928 (1950)	7, 9
Continental Bank v. Arizona Dep't of Revenue, 131 Ariz. 6, 638 P.2d 228 (Ariz. App. 1981)	7
Federal Products Corp. v. Norberg, 429 A.2d 447 (R.I. 1981)	7
First National Bank of Atlanta v. Bartow County Board of Tax Assessors, 105 S. Ct. 1516 (1985)	6
Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824)	6
M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819)	6
Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983)	6, 7, 8, 9
New Jersey Realty Title Ins. Co. v. Division of Tax Appeals, 338 U.S. 665 (1950)	6
Phillips Petroleum Co. v. Dumas Independent School District, 360 U.S. 376 (1960)	8
Schuylkill Trust Co. v. Pennsylvania, 296 U.S. 113 (1935)	6, 8, 9
Schwinden v. Burlington Northern, Inc., 691 P.2d 1351 (Mont. 1984)	7
Smith v. Davis, 323 U.S. 111 (1944)	6, 9
Society for Savings v. Bowers, 349 U.S. 143 (1955)	6
State ex rel. Douglas v. Karnes, 216 Neb. 750, 346 N.W. 2d 231 (1984)	7

PAGE

Werner Machine Co. v. Director of Division of Taxation, 350 U.S. 492 (1956) 6

Weston v. City Council of Charleston, 27 U.S. (2 Pet.) 449 (1829) 6

Statutes

31 U.S.C. § 742 .....2, 4, 7, 8

Rules

Sup. Ct. Rules, Rule 17 ..... 6, 7

Other Authorities

Administrative Code of the City of New York § R46-4.0(8) 2, 3, 4

N.Y. Times, November 20, 1985 9

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1371

DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK,

Petitioner,

v.

FORBES INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE NEW YORK COURT OF APPEALS

BRIEF IN OPPOSITION

Forbes Inc. ("Forbes") respectfully submits this brief in opposition to the petition for a writ of certiorari (the "petition") of the Department of Finance of the City of New York (the "City").

STATEMENT OF THE CASE

The City's unique rules for allocating corporate investment income place a greater tax burden upon holders of federal obligations than upon holders of other obligations. This fact—proven to a mathematical certainty in the proceedings below, and conceded by the City in the court below—led the New York Court of Appeals to conclude, in accordance with a long

line of applicable precedent, that the City tax law discriminates against federal obligations, in violation of 31 U.S.C. § 742 and hence, in violation of the Supremacy Clause. The City's rules (i) favor the obligations of the 49 states other than New York over federal obligations, and (ii) penalize any taxpayer which places more than 82% of its investment portfolio in federal obligations.

A. The New York City General Corporation Tax

1. The Income Allocation Rules—Calculation of The Investment Allocation Percentage

The New York City General Corporation Tax imposes a tax upon that portion of a corporation's income which is "allocated" to the City pursuant to rules set forth in the Administrative Code of the City of New York (the "Code").

The portion of a taxpayer's *business income* allocated to the City is determined by multiplying the taxpayer's total business income by the taxpayer's "business allocation percentage" ("BAP"), the percentage of the *taxpayer's* business or capital in the City, as determined by a statutory formula.

The portion of a taxpayer's *investment income* allocated to the City is determined by multiplying the taxpayer's total investment income by the taxpayer's "investment allocation percentage" ("IAP"). Unlike the BAP, the IAP is not based on the *taxpayer's* contacts with the City, but on the collective, allocable contacts with the City of the *issuers* of the securities in which the taxpayer has invested.

With respect to *investment income* from *corporate obligations*, the *taxpayer's* IAP is based on the *issuers'* BAPs, allocated according to the taxpayer's relative investment in each such obligation. However, different allocation rules apply to *investment income* from *government obligations*:

(1) Obligations of the 49 states other than New York ("state obligations") are allocated wholly outside the City (i.e., they have an IAP of zero).

(2) Obligations of the federal government, and obligations of the State of New York ("New York obligations") are allocated in accordance with the otherwise prevailing IAP calculated by reference to the taxpayer's other investments (i.e., they have no independent IAP).

(3) If the taxpayer's IAP is zero—that is, if a taxpayer has not invested in corporate obligations, or has invested in the obligations of corporations all of which have BAPs of zero—interest income from federal obligations and from New York obligations (but not state obligations) is allocated in accordance with the taxpayer's BAP (which usually is much higher than its IAP).[1]

The IAP is a fraction. The numerator is the combined, allocated fair market value of all corporate obligations held by a taxpayer. The denominator is the taxpayer's "total investment capital," which the Code defines so as to *include* the value of corporate obligations and *state obligations*, but to *exclude* the value of *federal obligations* and *New York obligations*. For the tax years at issue—1977, 1978 and 1979—Forbes' IAP, calculated under the Code rules, ranged from approximately 1.4 percent to approximately 5.7 percent.

2. The 18 Percent Rule

Code § R46-4.0(8) vests the Commissioner of Finance (the "Commissioner") with "discretionary" power to adjust a taxpayer's IAP. It provides in pertinent part:

> If it shall appear to the [Commissioner] that any business or investment allocation percentage determined as hereinabove provided does not properly reflect the activity, business, income or capital of a taxpayer within the city, the [Commissioner] shall be authorized in his discretion . . . in the case of an investment allocation percentage *to adjust it by excluding* one or more assets in

---

1 The Code provisions setting forth the method for calculating the taxpayer's IAP are quoted at pages 5-7 of the petition.

> computing such percentage provided the income therefrom is also excluded in determining entire net income. (emphasis supplied)

In an audit of Forbes' tax returns, a City auditor calculated for each tax year the ratio between the value of Forbes' investments in corporate securities and the total value of Forbes' entire investment portfolio. The auditor had been instructed that if that ratio were less than 18 percent, the Commissioner's "discretionary" power should automatically be invoked.

Because the vast majority of its investments were in federal obligations, the foregoing ratio derived from Forbes' tax returns was well below 18 percent. The auditor automatically "adjust[ed]" Forbes' IAP by "excluding" Forbes' investments in corporate obligations. This reduced Forbes' IAP to zero. Accordingly, none of Forbes' income from corporate obligations was taxable, but Forbes' income from federal obligations was allocated (and became taxable) based upon Forbes' BAP (of approximately 60 percent) rather than its IAP (of approximately 1.4 to 5.7 percent).

The net result of these recalculations was that the City assessed against Forbes additional taxes in excess of $68,000, plus interest. Forbes challenged those assessments in the New York courts.

B. The Decision Below

In a unanimous decision (with one judge not participating), the New York Court of Appeals held that the City tax law "places a greater [tax] burden on taxpayers holding federal obligations, thus making them less attractive investments . . . ." (Appendix ["A"]-13a) Accordingly, the court concluded that the City tax laws discriminate against federal

obligations, in violation of 31 U.S.C. § 742 and the Supremacy Clause. The Court of Appeals specifically held:

> 1. The statutory formula for calculating the IAP discriminates against federal obligations in favor of state obligations by including the value of state obligations, but not federal obligations, in the denominator of the fraction, thereby permitting investments in state obligations, but not federal obligations, to lower the fraction and decrease the amount of taxable income. This makes state obligations more attractive to investors because, all other factors being equal, a taxpayer which invests in state obligations has a lower IAP, and pays less tax, than a taxpayer which invests in federal obligations. (A-13a-16a, 23a)
>
> 2. The 18 percent rule discriminates against federal obligations by penalizing a taxpayer which, like Forbes, invests more than 82 percent of its portfolio in federal obligations (or in any obligations, including federal obligations, other than those of corporations with low BAPs). (A-16a-18a, 23a)
>
> 3. This discrimination cannot be justified on the ground that the City tax law would satisfy a "rational basis" test applicable in a due process or an equal protection case. That test is not relevant under section 742, where the controlling issue is simply whether the tax adversely affects federal obligations in comparison to other obligations. (A-24a-26a)
>
> 4. The discrimination cannot be justified on the ground that the City tax law treats federal obligations and New York obligations identically. State obligations are taxed more leniently than federal obligations, thereby threatening the statutory goal of preserving federal borrowing power. (A-26a-28a)

SUMMARY OF ARGUMENT

There are no "special and important reasons" why this Court should exercise its discretion to review this case. *See* Rule 17, Sup. Ct. Rules. The case presents no unsettled question of federal law. The decision below does not conflict with decisions of this Court, or of any state court of last resort, and is in any event correct. The case presents an issue of limited significance and impact. Accordingly, the petition should be denied.

ARGUMENT

THERE ARE NO SPECIAL AND IMPORTANT REASONS FOR REVIEW

As set forth below, there are no "special and important reasons" why this Court should exercise its discretion to review this case.

A. This Case Presents No Unsettled Question

This case presents no unsettled question of federal law. On the contrary, the decision below is nothing more than a routine application of the law established in this Court's applicable precedents—some nearly as old as the Republic itself[2]—which have been repeatedly[3] and recently[4] reaffirmed. The decision

---

2 *See, e.g., M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819); *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824); *Weston v. City Council of Charleston*, 27 U.S. (2 Pet.) 449 (1829).

3 *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935); *Smith v. Davis*, 323 U.S. 111 (1944); *New Jersey Realty Title Ins. Co. v. Division of Tax Appeals*, 338 U.S. 665 (1950); *Society for Savings v. Bowers*, 349 U.S. 143 (1955); *Werner Machine Co. v. Director of Division of Taxation*, 350 U.S. 492 (1956).

4 *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983); *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983); *First National Bank of Atlanta v. Bartow County Board of Tax Assessors*, 105 S. Ct. 1516 (1985).

on which the Court of Appeals relied most directly—*Memphis Bank*—is a unanimous decision of three years' standing.

Thus, the case presents no "question of federal law which has not been, but should be, settled by this Court . . . . " Rule 17(c), *supra*. This Court has already defined the boundaries of state and local taxation of federal obligations under section 742. Indeed, it has addressed that statute on three occasions within the past three years, rendering decisions which provide clear and controlling guidance to the state courts. *See* note 3, *supra*.

The court below applied settled law to the case at hand. Nothing in the circumstances of this case—much less anything in the City's petition—provides the slightest reason why this Court should exercise its discretion to revisit these issues.

B. This Case Presents No Decisional Conflict

There is simply no reason to grant certiorari where, as here, the decision below stands not in conflict, but rather in harmony, with the decisions of this Court and the decisions of state courts which have addressed the issue presented.[5] Here, the Court of Appeals carefully reviewed no less than seven applicable decisions of this Court to find the test for "discrimination" under 31 U.S.C. § 742. (A18a-23a) The Court of Appeals quoted and applied the rule stated in *Memphis Bank*, a rule distilled from more than 150 years of constitutional litigation: "A 'state tax that imposes a greater burden on holders of federal property than on holders of similar state property impermissibly discriminates against federal obligations.' " (A-22a) The Court of Appeals held that the City tax "unquestionably" failed this test. (A-23a)

---

5 *Schwinden v. Burlington Northern, Inc.*, 691 P.2d 1351 (Mont. 1984); *State ex rel. Douglas v. Karnes*, 216 Neb. 750, 346 N.W. 2d 231 (1984). *See also Commonwealth v. Curtis Publishing Co.*, 363 Pa. 299. 69 A.2d 410 (1949), *cert. denied*, 339 U.S. 928 (1950); *Continental Bank v. Arizona Dep't of Revenue*, 131 Ariz. 6, 638 P.2d 228 (Ariz. App. 1981); *Federal Products Corp. v. Norberg*, 429 A.2d 447 (R.I. 1981).

There is no suggestion in the petition—nor could there be—that the Court of Appeals' decision stands in conflict with *Memphis Bank*, or with any of the decisions of this or any other Court under section 742.

The City hints at a supposed conflict between the decision below and "[t]he approach" of the Court in *Phillips Petroleum Co. v. Dumas Independent School District*, 360 U.S. 376 (1960). *Phillips*, however, did not arise under section 742. Moreover, *Phillips* held that the "rational basis" test advocated by the City—a test drawn from equal protection cases—is not applicable where, as here, "problems of intergovernmental tax immunity are involved." 360 U.S. at 385. That, of course, is precisely what the Court of Appeals held below. The decision below is absolutely consistent with *Phillips*, in legal principle, in language, and in result.[6]

C. The Decision Below is Correct

In any event, the decision below is correct and warrants no further review. A simple exercise in mathematics (as reflected in the Court of Appeals decision, A-13a-18a) demonstrates that a taxpayer must pay a higher tax, all other factors being equal, when it invests in federal obligations. The Court of Appeals correctly held, in language drawn from *Memphis Bank*, that "the City tax unquestionably imposes a greater burden on holders of Federal obligations than on holders of certain other obligations, and thereby diminishes to some degree the investment attractiveness of Federal obligations." (A-23a) As noted above, this is clearly the correct test to apply. The discrimination was, in fact, so patent that the City conceded this issue in the court below.[7] (A-23a)

---

6 Even *Phillips* rejected the school district's argument in justification of a discriminatory tax on lessees of federal property.

7 Apparently, the City would seek in this Court to withdraw that concession. It argues that there is no discrimination because "the percentage of receipts taxed"—presumably, the 9% tax rate—is the same for all property. Petition at 13. This argument is frivolous. Discrimination derives from the statutory rules which determine *how*

Finally, the Court of Appeals held—correctly, in light of *Memphis Bank*, *Smith v. Davis*, 323 U.S. 111, 117 (1944), and *Schuylkill Trust Co. v. Pennsylvania*, *supra*, 296 U.S. at 120—that the tax law could not be salvaged merely because it treats New York obligations as badly as it treats federal obligations. (A-26a) "[T]he statutory goal of preserving Federal borrowing power is threatened whenever any other class of obligations is taxed more leniently than Federal obligations." (A-26a)

D. This Case Presents an Issue of Limited Significance and Impact

This case presents no issue of nationwide significance warranting discretionary review in this Court. It appears that the decision will have no impact outside the State of New York. Research has not disclosed any city or state, other than New York City and New York State, that uses investment income allocation rules of the kind involved here. The City does not contend otherwise.

Even within New York, the decision will apparently have little impact. As the City's counsel has publicly stated, most of the City's tax revenues are derived from taxes upon *business* income and therefore are not affected by the decision below, which invalidates only the rules for allocating *investment* income. *See N.Y. Times*, November 20, 1985, at D17. Because the decision below will have little impact even within the City

---

much income, and *which* income, is subject to taxation and which result in a greater tax burden on federal obligations, whether or not the overall "tax rate" is uniform.

Also meritless is the City's argument—never raised below—that the laws do not *intentionally* discriminate. Petition at 13. The absence of a discriminatory intent does not save a tax which actually imposes a greater tax burden on the holders of federal obligations. *Memphis Bank & Trust Co. v. Garner*, *supra*, 459 U.S. at 397-98; *Schuylkill Trust Co. v. Pennsylvania*, *supra*, 296 U.S. at 119-20 (examining the "operation" of the law); *Commonwealth v. Curtis Publishing Co.*, *supra*, 363 Pa. at 324, 69 A.2d at 421-22.

itself, discretionary review in this Court is particularly inappropriate.

CONCLUSION

There are no "special and important reasons" why this Court should exercise its discretion to review this case. Accordingly, the petition for a writ of certiorari should be denied.

Dated: New York, New York
March 14, 1986

Respectfully submitted,

/s/ ARNOLD BAUMAN

Arnold Bauman
Counsel of Record

SHEARMAN & STERLING
53 Wall Street
New York, New York 10005
(212) 837-6860

Of Counsel:
CLARENCE W. OLMSTEAD, JR.
WILLIAM E. FLOWERS
KENNETH A. CARUSO
DANIEL LAVIN

Attorneys for Respondent

LIST OF SUBSIDIARY CORPORATIONS

Forbes Inc.

Subsidiaries

Forbes Investors Advisory Institute Inc.
Forbes Investors Advisory Institute Inc. (Delaware)
Forbes Trinchera Inc.
Sangre de Cristo Ranches Inc.
Fiji Forbes Inc.
Forbes Europe Inc.
Slegers-Forbes Inc.
Social Register Association